



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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Dear [REDACTED]:

This letter is in response to your inquiry addressed to Senator Christopher J. Dodd, dated [REDACTED], requesting the views of the Internal Revenue Service (IRS) on the income and employment tax consequences of a proposed ordinance. The ordinance abates the real property or motor vehicle taxes of volunteer firefighters and emergency medical technicians (firefighters) who meet specific requirements.

The IRS cannot provide rulings on the employment status of individuals for purposes of the Federal Insurance Contributions Tax (FICA) before Congress passes a law clarifying employment status. [Section 530(b) of the Revenue Act of 1978] I can give you some general information that I hope will be helpful.

Gross income means all income from whatever source, including fringe benefits received for services. Noncash benefits are included in gross income. Section 61(a) of the Internal Revenue Code (the Code).

The Supreme Court case *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929), held that an employer's payment of an employee's tax obligation was income to the employee. This case dealt with inclusion in gross income. If the income is also wages for FICA purposes, FICA taxes apply.

Whether FICA tax applies to remuneration for services depends on whether the remuneration is wages within the meaning of the Code. Sections 3101 and 3111 of the Code impose taxes on the wages paid by employers to employees with respect to employment. In general, all payments of remuneration by an employer for services performed by an employee are subject to FICA taxes, unless the payments are specifically excepted from the term wages or the services are specifically excepted from the term employment.

Wages are defined as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain exclusions.

Employment means any service performed by an employee for the person employing him, with certain exclusions.¹ Employee is defined as any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. [Code section 3121(d)(2)] In other words, whether income is wages for purposes of FICA depends upon whether the firefighters are employees under the common law.

The common law rule is that generally the employer-employee relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished but also as to the details and means by which that result is accomplished. [Section 31.3121(d)-1(c)(2), Employment Tax Regulations]

If the firefighters do not receive cash remuneration, the employer will not be able to withhold the employee FICA tax. The employer will have two choices, to pay the employee FICA or to seek remuneration from the firefighters. An employer's payment of employee FICA tax without withholding it from the employee is additional remuneration to the employee for purposes of income and FICA tax.

An exclusion from wages exists for FICA purposes for the employee portion of FICA tax paid by the employer without deduction from the employee's wages, but only in the cases of domestic service in the private home of the employer and agricultural labor. [Section 3121(a)(6)] In other words, if an employer pays the employee portion of the FICA tax on behalf of an employee, that amount is additional wages to the employee for FICA purposes. See Rev. Proc. 81-48, 1981-2 C.B. 623, attached, for the formula used to calculate the additional wages.

For purposes of Federal income tax withholding, wages means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash. [Code section 3401(a).] An employer's payment of employee FICA tax without withholding it from the employee's remuneration is additional income to the employee for income and withholding purposes. [Section 31.3401(a)-1(b)(6), Employment Tax Regulations.] Since the total of the maximum possible abatement and FICA tax reimbursement is less than the exemption amount, withholding will most likely not be required.

¹An exception from employment exists in Code section 3121(b)(7)(F) for state and local government employees who are participants in a retirement system. The firefighters in this case apparently do not satisfy this condition.

Tax under the Federal Unemployment Tax Act (FUTA) does not apply to compensation for services in the employ of a state, any political subdivision, or any instrumentality of any one or more of the foregoing which is wholly owned by one or more states or political subdivisions. [Code section 3306(c)(7)]

Every person required to deduct and withhold the employee portion of the FICA tax from an employee must report the information on Form W-2. The requirement applies to all payments subject to FICA tax, regardless of the amount. [Code section 6051(a)]

You also asked about the possibility of treating the tax abatements as reimbursement for expenses.

An employer can reimburse employees' business expenses under a "reimbursement or other expense allowance arrangement," so that the reimbursements will not be taxable to the employees for income and FICA purposes. Employees must substantiate bona fide business expenses to their employers and return any advances which exceed substantiated expenses. If the employer has a reimbursement or other expense allowance arrangement, then the employees may exclude reimbursed amounts from taxable income and FICA wages. The reimbursed amounts will also not be wages for FICA or income tax withholding purposes. In the absence of such an arrangement, amounts paid to employees for unsubstantiated expenses represent additional income and FICA wages to the employee. [Sections 62(c) of the Code and 1.62-2 of the Income Tax Regulations]

This letter will be made available for public inspection after names, addresses, and other identifying information have been deleted, as appropriate, under the Freedom of Information Act.

If you have any questions, please call Elizabeth Edwards, ID # 50-02101, at (202) 622-6040.

Sincerely,

Jerry E. Holmes
Branch Chief
Office of Associate Chief Counsel
(Tax-Exempt and Government Entities)
Employment Tax Branch 2

cc: The Honorable Christopher J. Dodd
United States Senate
Washington, D.C. 20510-0702

attachment